SUPREME COURT, U. S.

Supreme Court of the United States

October Term, 1973

No. 73-890

ERIE LACKAWANNA RAILWAY COMPANY, Debtor,
Petitioner,

vs.

NORFOLK AND WESTERN RAILWAY COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit

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PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit

Erie Lackawanna Railway Company respectfully prays that a writ of certiorari issue to review the order of the United States Court of Appeals for the Sixth Circuit entered on September 14, 1973.

OPINIONS BELOW

The Memorandum, Opinion and Order of the United States District Court for the Northern District of Ohio and the Order of the United States Court of Appeals for the Sixth Circuit, neither of which has been reported, appear in the Appendix hereto, *infra*, pp. A1-17.

JURISDICTION

The order of the United States Court of Appeals for the Sixth Circuit vacating the judgment of the District Court was entered on September 14, 1973. This petition for certiorari was filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED

On June 26, 1972, Erie Lackawanna Railway Company (the "Debtor") filed a Petition for Reorganization under Section 77 of the Bankruptcy Act.

On April 1, 1968, Norfolk and Western Railway Company, through a wholly owned subsidiary, acquired 100% of the common stock of the Debtor pursuant to an order of the Interstate Commerce Commission. During the period from April 1, 1968 through December 31, 1971, the Debtor sustained tax losses of approximately $88,000,000, and generated investment credits of about $3,227,000 on purchases of assets. After Norfolk and Western Railway Company acquired the common stock of the Debtor, it included the Debtor in the making and filing of its consolidated returns with respect to federal income taxes.

In the computation of the Debtor's losses, Norfolk and Western Railway Company made certain tax elections, the effect of which was to reduce substantially the basis of the Debtor's property and to increase its tax losses. In the consolidated returns, Norfolk and Western Railway Company used the tax attributes of the Debtor, its losses and investment credits, to offset its income and to reduce the tax liability of the affiliated group, primarily that of Norfolk and Western Railway Company.

The questions presented are:

1. Whether the tax attributes of Erie Lackawanna Railway Company, namely, its tax losses and investment credits, and the right to exercise tax elections, which Norfolk and Western Railway Company used for its own benefit, are "property" within the meaning of Section 77 of the Bankruptcy Act, title to which vests in the Trustees of the Debtor and over which the District Court has exclusive jurisdiction.

2. Whether the District Court, in order to protect the Debtor's property and prevent its erosion, may exercise its exclusive jurisdiction and control over that property by directing Norfolk and Western Railway Company, when it files a consolidated return that includes the Debtor, that the tax attributes of the Debtor are to be used and tax elections are to be made with respect to the property of the Debtor only as determined by the District Court.

STATUTES AND REGULATIONS INVOLVED

11 U.S.C. Section 205 (Section 77(a) of the Bankruptcy Act) and Section 1502 of the Internal Revenue Code of 1954, and Treas. Reg. Section 1.1502-77 appear in the Appendix hereto, *infra*, pp. A18-20.

STATEMENT OF CASE

On June 26, 1972, Erie Lackawanna Railway Company filed a petition for reorganization under Section 77 of the Bankruptcy Act, which petition was approved by the United States District Court for the Northern District of Ohio. Trustees were appointed on July 31, 1972, and were duly qualified on August 16, 1972.

On April 1, 1968, pursuant to an Order of the Interstate Commerce Commission, Norfolk and Western Railway Company ("N & W") through a subsidiary, Dereco, Inc., acquired 100% of the common stock of the Debtor in exchange for N & W stock with a value of $55,026,000. That Order was approved by this Court in *Penn-Central Merger and N & W Inclusion Cases*, 389 U.S. 486, 525-526 (1968).

For the calendar years 1968 through 1971, N & W has reported its income and that of its affiliates, including the Debtor from April 1, 1968, for federal income tax purposes by filing consolidated returns. In the consolidated returns filed for the years 1968 through 1971, N & W made certain elections, including accelerated methods of depreciation, guideline lives, asset depreciation range system, and amortization of rolling stock, with respect to the depreciable property of the Debtor. As a result of these elections, in the 45 months' period from April 1, 1968 through December 31, 1971, the tax basis of the Debtor's property was eroded by almost $53,700,000 more than it would have if N & W had employed the same methods of depreciation and had made the same elections as the Debtor did prior to its affiliation with N & W.

During the period from April 1, 1968 through December 31, 1971, the Debtor had losses for tax purposes of approximately $88,427,000 which were used by N & W in consolidated returns to offset its taxable income and thereby reduce its tax liability. In addition, the Debtor during that period generated investment credits of approximately $3,227,000, and these credits were utilized to some extent by N & W in further reduction of its tax liability.

On August 3, 1973, the Debtor filed an action for temporary restraining order, preliminary and permanent in-

junctions to restrain N & W from including in its 1972 consolidated return, which was due on September 17, 1973, the losses and credits of the Debtor that were generated after June 26, 1972, (the filing date of the petition for reorganization) and for an accounting and other equitable relief. At the time such action was initiated, the Debtor estimated that on the basis used by N & W in the 1971 return its loss for the entire year ended December 31, 1972 would be $30,000,000, and that for the period from June 27, 1972 through December 31, 1972 the loss would approach $15,000,000, its investment credit would approximate $850,000, and the use by N & W of so-called fast methods of depreciation and amortization would further erode the Debtor's basis of its property by $7,500,000.

On September 10, 1973, the District Court rendered its opinion that the tax attributes of the Debtor were property over which that Court had exclusive jurisdiction. Paragraph 3 of its Order provided:

> "3. N & W be and it is hereby authorized to file on or before September 15, 1973, a consolidated federal income tax return including the income, deductions, and credits of the Debtor and its subsidiaries for the calendar year 1972, prepared in such manner with respect to the Debtor, making such tax elections and taking such deductions and credits which are available to the Debtor as the Trustees, subject to the control of this Court, determine." Appendix, *infra*, p. A15.

The District Court reserved decision and retained jurisdiction to determine the amount of compensation, if any, that N & W is to pay the Debtor for the past, present and future use of the Debtor's tax attributes.

On September 14, 1973, the United States Court of Appeals for the Sixth Circuit vacated the judgment of the

District Court. The Court of Appeals held that the District Court had no authority to control the tax elections affecting the Debtor. The Court of Appeals refused to consider whether the loss and other tax attributes of the Debtor "constitute 'property' vesting in the Trustees under the Bankruptcy Act". Appendix, *infra*, p. A16.

REASONS FOR GRANTING THE WRIT OF CERTIORARI

1. Whether Tax Attributes Constitute "Property" for Bankruptcy Purposes Is an Issue of Crucial Significance in Bankruptcy Administration.

The paramount reason for granting this writ of certiorari is that the issue involved is of crucial significance in bankruptcy administration. The question of statutory interpretation presented—whether tax attributes, namely, net operating losses and investment credits, and the right to exercise tax elections, of a bankrupt are "property" within the meaning of the Bankruptcy Act—is a fundamental one which constantly recurs in bankruptcy administration. Furthermore, the resolution of this issue is one of prime concern to the railroad industry which finds seven major northeastern railroads, including the Debtor, in reorganization proceedings.

a. Tax Attributes Such As Losses and Investment Credits Are Property of Substantial Value That Can Be Realized upon for the Benefit of Creditors.

This Court has previously touched the periphery of the issue. *Segal v. Rochelle*, 382 U.S. 375 (1966). There, the question was whether income tax refunds through loss carrybacks arising out of business losses incurred prior to

bankruptcy were property subject to a turnover order in favor of the trustees. This Court concluded that the tax refund claims were property under Section 70a(5) of the Bankruptcy Act. In reaching that conclusion, this Court stated:

> "The main thrust of §70a(5) is to accrue for creditors everything of value the bankrupt may possess. . . . To this end the term 'property' has been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed." *Id.* at 379.

See 4A COLLIER ON BANKRUPTCY ¶70.15, at 137 (14th ed. 1971).

It cannot be denied that the tax losses and investment credits of the Debtor are assets of substantial value and that they can be realized upon for the benefit of creditors. Thus, they play a vital role in achieving the key objective of the Debtor's reorganization proceedings—to secure for creditors every asset of value that the Debtor may possess and to transform the Debtor into a viable and profitable railroad. The value to the Debtor of its tax attributes lies partially in the right to their use by N & W, a profitable, solvent railroad, through consolidated returns as an offset against its taxable income and a direct credit against its tax liability. *See Western Pacific Railroad Corp v. Western Pacific Railroad Co.*, 345 U.S. 247, 276-277 (1952), wherein Justice Jackson in a dissent reaching the merits of the controversy said:

> "We have two affiliated corporations subject to considerable, if not complete, common control, but with different minority interests. One has realized a huge loss the other has enjoyed large net income. If these two can be brought together, a tax saving

amounting in this case to some seventeen million dollars can be made for the profitable company. Congress has authorized, but has not required, that these two be merged by means of a consolidated tax return. Each has the right, but no legal duty, under federal law to join in consolidated returns.

"It may seem anomalous at first glance that a sustained loss can be realized upon as an asset. But it is not the loss; it is the right to use the loss as an offset that is valuable. The market for it is restricted, of course, but this detracts nothing from its value to one in a position to utilize it.

"Each of theses corporations had something to contribute to a tax-saving plan. Either one alone was helpless. But I know of no moral or legal obligation to give away any legal opportunity or advantage just because its owner cannot utilize it himself."

The value of the tax attributes of the Debtor is quickly apparent. For the 45 months' period from April 1, 1968 through December 31, 1971, N & W utilized approximately $88,000,000 of the Debtor's losses as an offset against its own income, a benefit to N & W that in some part rightfully belonged to and must be shared with the Debtor. These losses of the Debtor were created in large measure by the accelerated methods of depreciation elected by N & W which eroded substantially the Debtor's basis for its property. As a result, the Debtor will have a lower tax basis for its assets when it is reorganized than it would have if N & W had adopted tax accounting methods that were for the Debtor's benefit rather than that of N & W. Furthermore, N & W utilized a portion of the Debtor's $3,227,000 of investment credits to reduce its tax liability.

To allow N & W to receive substantial tax benefits arising solely from the Debtor's losses and investment credits, merely because consolidated returns were utilized as a procedural method for reporting income of the affiliated group, unjustly enriches N & W and enables it to use the property of the Debtor to the exclusion of its creditors. *See In re Bob Richards Chrysler-Plymouth Corp., Inc.*, 473 F.2d 262 (2nd Cir. 1973), *cert. denied*, May 29, 1973.

b. Tax Attributes Are Property Within the Meaning of Section 77(a) of the Bankruptcy Act.

Since these tax attributes of the Debtor are so valuable, it is crucial that they be marshalled and conserved for the benefit of the Debtor and its creditors—not N & W, its shareholder. Accordingly, it is incumbent upon the District Court which has jurisdiction over the Debtor to exercise control over and protect these valuable assets. *New Haven Inclusion Cases*, 399 U.S. 392 (1970). That control exists if the Debtor's tax attributes are "property" within the meaning of Section 77(a) of the Bankruptcy Act. The District Court below correctly concluded that the tax attributes were such property over which it exercises exclusive jurisdiction. The Court of Appeals below erred in sidestepping the resolution of that issue.

In *Segal v. Rochelle, supra*, this Court held that loss carryback refund claims arising out of pre-bankruptcy losses are property. *Accord, In re Bob Richards Chrysler-Plymouth Corp., Inc., supra.* It necessarily follows that losses sustained and investment credits generated during bankruptcy likewise fall within the scope of property. The Trustees should have the right to use those tax attributes to the same extent that the Debtor could have but for bankruptcy. *See* Section 6012(b)(3) of the Internal Revenue Code. However, in *Segal*, this Court expressly de-

clined to rule on the question of whether loss carryovers arising from losses sustained in pre-bankruptcy years are to be cloaked with the property label. 382 U.S. at 381. *Case v. New York Central Railroad Company*, 204 N.E.2d 643 (N.Y. Ct. App. 1965) involved an action by minority shareholders of a subsidiary of New York Central to rescind a tax allocation agreement among members of an affiliated group filing consolidated returns. That agreement provided that the profitable corporation must reimburse the loss corporation (Central) for a substantial portion of the taxes which it saved through the use in consolidated returns of Central's losses. In upholding the validity of that allocation agreement the court noted that ". . . the loss shown by Central was under some rather flexible circumstances an asset to Central. It could have been carried forward for seven years . . ." *Id.* at 647.

The issue presented here is complex and unanswered. *See* 4A COLLIER ON BANKRUPTCY ¶70.28, at 398-405 (14th ed. 1971). The time is, therefore, at hand for this Court to decide whether it will attach the property label to losses incurred during bankruptcy which may be carried forward for seven years. Section 172(b) of the Internal Revenue Code of 1954.

c. It Is of Crucial Significance to the Northeast Railroads in Reorganization That Their Tax Attributes Fall Within the Meaning of Property.

This issue of whether tax attributes are property is of importance not only to the Debtor but to other railroads in reorganization. In the ongoing Boston & Maine Railroad reorganization proceedings, the Trustees have taken the position that its operating loss carryovers are a valuable asset of the debtor's estate. Accordingly, it is contending that if its parent, Bomaine Corporation, which in consoli-

dated returns has used the losses of Boston & Maine to offset its income, wishes to continue realizing a benefit from the use of this asset it may do so only if it agrees to compensate Boston & Maine for use of its losses. Report and Order of Administrative Law Judge, I.C.C., Finance Docket No. 26115, p. 71; Bomaine Corporation 1972 Annual Report, p. 19, Note 4.

In the Matter of Lehigh Railroad Company, (E.D. Pa. Bankruptcy No. 70-432) Lehigh, in a situation comparable to that of the Debtor herein, claims that on the filing of its petition for reorganization it ceased to be a member of the affiliated group which included its parent, Penn Central Transportation Company. To protect the value of its asset —its losses—it seeks permission to file amended federal income tax returns on a separate return basis. In the action initiated below in the District Court by the Debtor, it too claimed that when it filed its petition on June 26, 1972 it ceased to be a member of N & W's affiliated group; accordingly, its losses could not be included in the 1972 consolidated return being filed by N & W.

It is apparent that the issue of whether tax attributes are property is not unique to the Debtor. The resolution of that issue by this Court can play a vital role in the reorganization plans of other railroads in reorganization so that their viability can be preserved in the public interest.

d. The Scope of Property with Reference to Tax Attributes Is a Recurring Problem in Bankruptcy Administration and a Conflict Exists in the Circuit Courts of Appeal As to Whether Tax Refunds Arising from Withholding Taxes Is Such Property.

That the scope of "property" within the meaning of the Bankruptcy Act is a recurring problem in bankruptcy administration is readily demonstrable. A conflict exists

between the Ninth and Second Circuits with respect to the question of whether income tax refunds resulting from withholding taxes are property within the meaning of Section 70a(5) of the Bankruptcy Act. In *In re Kingswood*, 343 F. Supp. 498 (C.D. Cal. 1972), *rev'd per curiam*, 470 F.2d 996 (9th Cir. 1973), petition for cert. filed August 13, 1973, (No. 73-289), the District Court held that the refunds were property belonging to the Trustee. The Court of Appeals for the Ninth Circuit reversed and chose to follow the opposite result reached in *In re Cedor*, 337 F. Supp. 1103 (N. D. Cal. 1972), *aff'd per curiam*, 470 F.2d 996 (9th Cir. 1972).

However, *In re Kokoszka*, 479 F.2d 990 (2nd Cir. 1973) is in direct conflict with the *Cedor* result. The Court of Appeals for the Second Circuit held that a tax refund is property passing to a bankruptcy Trustee under Section 70a(5). *In re Jones*, 337 F. Supp. 620 (D.C. Minn. 1971), *leave to appeal denied* (8th Cir. May 14, 1971), *cert. denied*, 404 U.S. 1040 (1972), held that income tax refunds of this nature were property. *See also In re Aveni*, 458 F.2d 972 (6th Cir. 1972), *cert. denied*, 409 U.S. 877 (1972), holding that wages earned prior to bankruptcy are property; *Lines v. Frederick*, 400 U.S. 18 (1970) holding that accrued but unpaid vacation pay was not property.

It is readily apparent that the issue now before this Court—are the losses, investment credits and other tax attributes of the Debtor property within the meaning of Section 77(a) of the Bankruptcy Act—is of significant immediate concern and importance involving millions of dollars that needs resolution by this Court. Furthermore, the recurring litigation involving the scope of "property" illustrates the need for the Supreme Court to give its authoritative answer to the question of whether tax attributes are such property.

2. Whether the District Court in Fulfilling Its Duty to Protect the Property of the Debtor, Including Its Tax Attributes, Can Direct the Parent As to What Tax Elections Are to Be Made in a Consolidated Return Which Affect the Debtor's Property Is a novel and Important Issue in the Administration of the Consolidated Returns Regulations.

This case involves the novel issue of whether the District Court can, in the exercise of its exclusive jurisdiction over the Debtor and its property, control tax elections, such as accelerated depreciation, asset depreciation range system and amortization of rolling stock, which directly affect that property when consolidated returns are filed that include the Debtor. The District Court below determined that the tax elections made by N & W substantially eroded—to the extent of about $53,700,000 through 1971—the tax basis of the Debtor's property as a result of which the Debtor could suffer irreparable damage. The District Court stated that such erosion could "critically affect the Trustees' ability to devise an acceptable and successful plan of reorganization." Appendix, *infra*, p. A8.

The course of action pursued by N & W of maximizing the depreciation and amortization deductions with respect to the Debtor's property served to increase its tax losses, all of which redounded to the benefit of N & W through the offset of those losses against its own income. The District Court properly determined that in view of the conflicting position in which N & W found itself the responsibility for determining what tax elections are to be made rested with the District Court.

> "Thus, the paradox of the dilemma confronting N & W is self-evident. To serve its own best corporate interests, it must, of necessity, elect a course of action

injurious to the Debtor. Conversely, to accede to the wishes of the Trustees would be prejudicial to its own best business interest. Under the existing circumstances, no stigma is intended against N & W for pursuing accepted, good business dictates in selecting the course most beneficial to its own position even though the ultimate consequence of its action may, in some degree, irreparably injure the property of the Debtor.

"Conscientious adherence to the Congressional mandate imposed upon the Court to protect and conserve the property of the Debtor permits no recourse but to relieve N & W of its burdensome conflict in discharging its fiduciary responsibilities." Appendix, *infra*, p. A10.

The Court of Appeals summarily disposed of the issue of who has the right to control the tax elections on the erroneous basis that it could find no authority for a court to order what income or deductions to include in a tax return. It could find none because of the uniqueness of the issue—a parent and an insolvent subsidiary in conflicting positions, the former doing everything to maximize the losses of the Debtor subsidiary through the utilization of accelerated methods of depreciation, and the latter striving to minimize its losses through the utilization of conservative methods of depreciation. The correct resolution of that issue was reached by the District Court. The District Court found, and the Court of Appeals below overlooked this finding, that the tax elections made by N & W affect the Debtor's property. Therefore, it was incumbent upon the District Court in protecting that property to relieve N & W of its responsibility for making those elections. The consolidated returns regulations do not compel a different result.

It is true that N & W, as the common parent of the affiliated group, is designated in the consolidated returns regulations as the agent for the Debtor, but that authority is confined to N & W's dealings with the Treasury and Internal Revenue Service in matters relating to the consolidated tax liability. Regs. Sec. 1.1502-77(a). The obvious purpose of the regulation's designating the parent as the representative for all members of the affiliated group is procedural and solely a matter of convenience in the administration of the tax laws. That regulatory provision is not intended to, nor does it, create legal rights between the Debtor and N & W in their relationship with one another.

That this analysis of the relationship between the Debtor and N & W is correct is buttressed by the recent decision of the Court of Appeals for the Second Circuit, *In re Bob Richards Chrysler-Plymouth Corp., Inc., supra.* There, the dispute was over which corporation in an affiliated group was entitled to an income tax refund—the bankrupt which had the earnings or the parent corporation to which the refund check had been sent. Relying on *Segal v. Rochelle, supra,* the Court held that the bankrupt was entitled to the refund. The Court made the following comments with respect to the parent's position as agent for the subsidiary under the consolidated return regulations.

> "The only reason for the tax refunds not being paid directly to the subsidiary is because income tax regulations require that the parent act as the sole agent, when duly authorized by the subsidiary, to handle all matters relating to the tax return. Accordingly, the refund is made payable to the parent and the acceptance of the refund by the parent discharges any liability of the government to any subsidiary. But these regulations are basically procedural in purpose

and were adopted solely for the convenience and protection of the federal government." 473 F.2d at 265.

Accordingly, the answer to the question of whether the Debtor or N & W controls the tax elections affecting the Debtor's property is not found in the consolidated returns regulations. The answer depends on whether tax attributes are property. If they are, then Section 77(a) of the Bankruptcy Act vests in the District Court exclusive jurisdiction over that "property". This Court in *Segal* has stated that the definition of "property" is to be determined in the light of the purposes of the Bankruptcy Act. 382 U.S. at 379. The purposes of that Act obviously differ from those of the consolidated returns regulations under the Internal Revenue Code. The main thrust of Section 77(a) of the Bankruptcy Act is to secure for creditors all assets of the Debtor, and to transform it into a living, sound railroad for the benefit of the public, whereas Regs. Sec. 1.1502-77 are merely procedural in purpose to protect the government against having to deal with a multiplicity of parties. The purposes of the Bankruptcy Act must prevail over those of the consolidated returns regulations. Accordingly, since the tax elections vitally affect the Debtor's property, the right to exercise those elections must rest solely with the District Court.

The Court of Appeals failed completely to grasp the point at issue: Who should exercise control and jurisdiction over the property of the Debtor, the District Court which is charged with the responsibility of obtaining and conserving every asset of the Debtor whether minimal or contingent, or N & W whose selfish interests compelled it to a course of action that eroded the Debtor's property and maximized the Debtor's loss, all to the benefit of N & W to the extent of at least $88,000,000? The mere statement of the question quickly dictates the answer—the District

Court should exercise control over the property of the Debtor, because the contrary response would deprive the District Court of that jurisdiction and control over the Debtor's property which the Bankruptcy Act confers only upon it.

It is apparent that a crucial aspect of the Debtor's chances of being metamorphosed into a viable, profitable railroad depends upon the ability of the District Court to determine what use is to be made of its tax attributes. Substantial efforts are being expended by Congress and the Administration to resolve the plight of the bankrupt northeast railroads. In furtherance of these efforts, on November 8, 1973, the House of Representatives passed a Bill, known as the "Regional Rail Reorganization Act of 1973", which has as one of its purposes and effects the reorganization of the ailing northeast railroads into an economically viable rail system. H.R. 9142, 93rd Cong., 1st Sess. (1973). If this Bill, or one of similar effect, is enacted, the significance of minimizing now the depreciation deductions of the Debtor and thus reducing its losses becomes apparent. The erosion of the Debtor's tax basis would be preserved to the point where depreciation deductions would be available as an offset against income in subsequent profitable years. Such a course of action would inure to the benefit of the creditors of the Debtor and the general public, which is where that benefit rightfully belongs.

The Court of Appeals committed grievous error in failing to determine that the Debtor's tax elections should be exercised by the District Court, thereby erroneously placing the responsibility for exercising tax elections involving the Debtor's property in the hands of N & W which has utilized the Debtor's tax attributes for its own substantial benefit to the exclusion of the Debtor and its creditors and contrary to the public interest.

CONCLUSION

For these reasons a writ of certiorari should issue to review the order of the Court of Appeals for the Sixth Circuit.

Respectfully submitted,

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APPENDIX

OPINION AND ORDER OF THE DISTRICT COURT

(Filed September 10, 1973)

THE UNITED STATES DISTRICT COURT
THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In Proceedings for the Reorganization of a Railroad
No. B72-2838

IN THE MATTER OF
ERIE LACKAWANNA RAILWAY COMPANY
Debtor

MEMORANDUM, OPINION and ORDER NO. 147

KRUPANSKY, *J.*

This is an action initiated by the Trustees of Erie Lackawanna Railway Company (Erie) for a permanent injunction restraining the Norfolk and Western Railway Company (N & W) from filing any federal, state, or local consolidated, combined, or joint tax returns including the income, deductions and credits of the Debtor, Erie, for any period subsequent to June 26, 1972, together with an accounting and other equitable relief.

On June 26, 1972, the Debtor, Erie, filed a petition for reorganization under Section 77 of the Bankruptcy Act, which petition was approved by this Court in Order No. 1 vesting exclusive jurisdiction over the Debtor and its property in this Court. Trustees were appointed on July 31, 1972, and were duly qualified on August 16, 1972. All title

to property including the rights, privileges, powers and duties to operate and manage the Debtor's business and properties were, on that date, vested in the Trustees subject to the control of this Court. 11 U.S.C. §205, as amended.

In this action, it is asserted by the Trustees that tax losses, investment credits, and all other tax attributes of the Debtor and the right to their exercise and use are property rights of the Debtor, title to which is vested in the Trustees subject to the exclusive jurisdiction of this Court.

Introductory to the issues here in controversy, the following summary leading to the adversary position of the parties is essential for a basic understanding requisite to a final determination.

The Norfolk and Western system acquired ownership of 100% of the voting stock of Erie on April 1, 1968, pursuant to an Order of the Interstate Commerce Commission which followed lengthy proceedings initiated by Erie with a Petition for Inclusion before said Commission seeking to order N & W to include Erie in its system. The N & W resisted the order charging that Erie was at best a marginal railroad with no reasonable prospect of long-range profitable operations.

In support of its Petition for Inclusion, Erie successfully maintained that N & W would realize a net tax savings of approximately $1,000,000 annually after inclusion through use of tax investment credits generated by Erie, together with other tax deductions which would virtually insure the investment in Erie which N & W would be required to make under the plan for inclusion.

By order of the ICC dated January 9, 1967, N & W was compelled to acquire Erie's stock. N & W exercized its right of appeal, however, the ICC order was ultimately sus-

tained by the Supreme Court of the United States on January 15, 1968. *Penn-Central Merger and N & W Inclusion Cases,* 389 U.S. 486 (1968). Pursuant to approval by the ICC, acquisition of all of Erie's voting stock by N & W was accomplished by and through its totally owned subsidiary, Dereco, thus permitting N & W to completely insulate itself from the accrued indebtedness and future liabilities of Erie, but retaining wide flexibility to utilize all advantages collateral to the inclusion of Erie in its system.

Thereafter, Erie had a substantial deficit in each of the years from 1968 to 1972.

N & W has filed consolidated tax returns for its system lines since 1954. When Erie became part of this system, N & W was required by Section 1502 of the Internal Revenue Code and the regulations thereunder to include Erie in its consolidated return. By virtue thereof, N & W made the available elections which reduced consolidated tax liability, including accelerated methods of depreciation, guideline lives, the asset depreciation range system, and amortization of rolling stock in determining the net income or loss of Erie for consolidated tax return purposes. These are the elections which the N & W used for itself and other members of the N & W system. As a result of N & W's use of these tax accounting methods and the large losses suffered by the Erie since its acquisition, the N & W has received substantial tax benefits from its right to include Erie in its consolidated return.

The ratio between N & W's actual dollar investment in Erie, to date, and the substantial tax benefits received resulting from the ICC inclusion order is not clearly reflected by the evidence before the Court. Whatever that ratio proves to be, it must be received and considered within the context of Section 77 of the Bankruptcy Act.

Undeniably, the ultimate objective of a reorganization proceeding is the metamorphosis of a debt-ridden, unprofitable railroad into a dynamic, viable company capable of serving the general public in the interests of both the national economy and defense.

To accomplish this transition, it is necessary to reduce or liquidate indebtedness incurred during years of unprofitable operation. This task, inherent in all reorganization proceedings, is neither simple nor pleasant, for success dictates that creditors, secured and general, stockholders, and the public must stand ready to assume a share of the burden, so that a viable enterprise may emerge from the proceedings for the benefit of all. Thus, N & W cannot claim preferential treatment and must stand with the public and the creditors and await the outcome of the reorganization with optimism.

The broad scope of authority vested in a Reorganization Court by Congressional enactment of Section 77 of the Bankruptcy Act is explicitly defined by the pronouncements of the Supreme Court in the *New Haven Inclusion Cases,* 399 U.S. 392, 420, (1970) where it stated:

> The jurisdiction of the reorganization court was not open to question. Upon its approval of the New Haven's petition for reorganization in 1961, that court had acquired "exclusive jurisdiction of the debtor and its property wherever located * * *." Bankruptcy Act, §77 (a), 11 U.S.C. §205 (a). Subject to the court's control, the trustees whom it appointed were empowered "to operate the business of the debtor." Id., §77 (c) (2), 11 U.S.C. §205 (c) (2). They were thus charged with the dual responsibility of conserving the debtor's estate for the benefit of creditors and preserving an ongoing railroad in the public interest. Massachusetts v. Bartlett, 384 F. 2d 819, 821, cert. denied, 390 U.S.

1003, 88 S.Ct. 1245, 20 L. Ed. 2d 103; 5 Collier on Bankruptcy ¶77.02, at 469-470 (14th ed. 1969). With these goals in view, the statute bestowed a "broad and general" authority upon both the court and the trustees. Cf. Palmer v. Massachusetts, 308 U.S. 79, 85, 60 S.Ct. 34, 37, 84 L. Ed. 93. The provisions of §77 "doubtless suffice[d] to confer upon the [reorganization court] power appropriate for adjusting property rights in the railroad debtor's estate and, as to such rights, beyond that in ordinary bankruptcy proceedings." Id., at 85-86, 60 S.Ct., at 37; Cf. 5 Collier, supra, ¶77.11, at 498-499.

Apparent from the foregoing, on June 26, 1972, when the petition for reorganization was filed by Erie, the Court's jurisdiction vested to adjudicate controversies relating to all property in the actual or constructive possession of the Debtor. *Thompson v. Magnolia Petroleum Co.*, 309 U.S. 478 (1940).

It necessarily follows that an affirmative finding by the Court that Debtor's tax attributes constitute "property" within the intent and meaning of Section 77 would bring such property within the orbit of the Court's exclusive jurisdiction.

Tax losses have been consistently recognized as assets of definitive value as emphasized by the language of Mr. Justice Jackson's dissent in *Western Pacific Railroad Corp. v. Western Pacific Railroad Co.*, 345 U.S. 247, 273 (1956).

Electing to comment upon the merits of the controversy rather than the procedural aspects considered by the majority of the Court in disposing of the case, Justice Jackson pragmatically characterized tax losses as assets of value for which compensation could be realized, a concept long recognized in commercial circles.

"We have two affiliated corporations subject to considerable, if not complete, common control, but with different minority interests. One has realized a huge loss; the other has enjoyed large net income. If these two can be brought together, a tax saving amounting in this case to some seventeen million dollars can be made for the profitable company. Congress has authorized, but has not required, that these two be merged by means of a consolidated tax return. Each has the right, but no legal duty, under federal law to join in consolidated returns.

It may seem anomalous at first glance that a sustained loss can be realized upon as an asset. But it is not the loss; it is the right to use the loss as an offset that is valuable. The market for it is restricted, of course, but this detracts nothing from its value to one in a position to utilize it.

Each of these corporations had something to contribute to a tax-saving plan. Either one alone was helpless. But I know of no moral or legal obligation to give away any legal opportunity or advantage just because its owner cannot utilize it himself.

* * *

On the face of it, the conclusion would seem warranted that the plaintiff is entitled to what fair arm's-length bargaining would probably have yielded. To ask this can hardly be stigmatized as capitalizing mere nuisance value. This is not the blackmailing transaction which offers to forego doing another injury if bought off. This merely seeks a share in the benefit which it transferred."

Western Pacific Railroad Corp. v. Western Pacific Railroad Co., supra 276, 277.

The Supreme Court in 1966 recognized that the term "property" as used in Section 70(a)(5) of the Bankruptcy Act must be construed "most generously" and that a tax loss carryback is not outside the reach of the Bankruptcy Court merely ". . . because it is novel or contingent or because enjoyment must be postponed." *Segal v. Rochelle*, 382 U.S. 375 (1966) at 379. Accord, *Danielson v. United States*, 416 F. 2d 408, 410 (9th Cir., 1969); *In Re Treguboff*, 305 F. Supp. 1013, 1016, 1017 (C.D. Calif. 1968); *Kennedy v. Powell*, 366 F. 2d 346, 348 (9th Cir., 1966), *cert. denied*, 368 U.S. 910 (1966). See also *Case v. New York Central Railroad Company*, 204 N.E. 2d 643, 647 (N.Y. Ct. App. 1965), where it was recognized that ". . . the loss shown by Central was under some rather flexible circumstances an asset to Central. It could have been carried forward for seven years. . ."

Contrary to the position of Norfolk and Western, *In re Scranton Corp.*, 235 F. Supp. 770 (M.D. Pa. 1964), also supports the proposition that the right to make a tax loss available to another corporation through a consolidated return is a property right. The *Scranton* court recognized jurisdiction over the subject matter of the Tax Court litigation but like this Court, found it unnecessary to enjoin Tax Court proceedings to protect the property of the Debtor. See also *In re Penn Central Transportation Company*, 453 F. 2d 520 (3rd Cir. 1972).

In light of the foregoing authority, the Court concludes that tax losses are property within the intent and meaning of Section 77 of the Bankruptcy Act over which the Court may, within its discretion, exercise exclusive summary jurisdiction.

Similarly, tax elections as to the methods of depreciation and amortization which are to be taken by N & W affect the property of the Debtor which it is the duty of

the Trustees and this Court to protect. At the hearing, Trustees introduced a comparative analysis between the deduction claimed by N & W with respect to Erie property in consolidated returns from April 1, 1968 through December 31, 1971 with the deductions which would have been taken under the depreciation methods and procedures used by Erie prior to affiliation. For the forty-five month period, the excess claimed by N & W on the so-called fast write-off methods approached $53,700,000. The Trustees estimate that the difference in depreciation deductions for the full year 1972 would approximate $15,200,000, of which approximately $7,500,000 would relate to the period between June 26 and December 31, 1972.

In Rev. Rul. 68-48, 1968-1 Cum. Bull. 301, 303, the Internal Revenue Service ruled that "[a] trustee in bankruptcy must use the bankrupt's adjusted basis when computing gain or loss on the sale of assets for the benefit of the estate in bankruptcy." Under Section 167 (g), "[t]he basis on which exhaustion wear and tear . . . are to be allowed . . . shall be the adjusted basis provided in Section 1101 . . . ." Thus, the Debtor would have a lower basis on which to compute gain or loss from the sale of assets and to compute further depreciation should Norfolk and Western be permitted to continue to exercise the Debtor's tax elections.

Clearly this substantial erosion of the tax basis of the Debtor's property will result in irreparable damage and critically affect the Trustees' ability to devise an acceptable and successful plan of reorganization.

The fact that the debtor cannot presently use either its tax losses or the increased basis of its assets does not diminish the obligation and duty of this Court to protect all of the property and rights of the bankrupt whether these be contingent or inchoate. *Segal v. Rochelle, supra.*

N & W's assertion that the Debtor cannot profitably use its tax attributes now or in the immediate future does not divest this Court of jurisdiction over such property.

Erie's investment credits like its tax losses come within the same property classification subject to the Court's jurisdiction.

The reorganization court sitting in equity would be remiss to foreclose the only forum available to the Trustees to protect and preserve the Debtor's property rights. That the Trustees have no adequate remedy at law is demonstrated by an analysis of applicable statutory enactments and treasury regulations.

Treasury Regulations Sections 1.1502.75; 1.1502.77, promulgated pursuant to 26 U.S.C. Section 1502 effectively:

1. Preclude the Trustees from applying to the Commissioner for permission to withdraw from the affiliated group;
2. Preclude the Trustees from representing the Debtor's interests in any proceeding related to tax liability, elections etc. before either the Commissioner of Internal Revenue or the Tax Court of the United States; and
3. Require the Trustees to recognize and rely upon its parent N & W as its agent in all matters before the aforementioned tribunals.

Stripped of authority to either initiate or pursue any action for relief before the only available forums expressly created by statute to afford relief, the Trustees must, of necessity, resort to the reorganization court to implement its statutory duty to protect the Debtor's property.

Of equal concern to the Court is the apparent conflict of interest impressed upon N & W by the reorganization proceedings.

N & W as parent-agent of the affiliated group, invested with plenary authority to determine without recourse the use of Erie's property for tax purposes was free to exercise such privilege so long as a common interest, free of conflict, prevailed between parent and subsidiary.

The impact of the intervening reorganization condemned the relationship to one of irreconcilable conflict.

Thus, the paradox of the dilemma confronting N & W is self-evident. To serve its own best corporate interests, it must, of necessity, elect a course of action injurious to the Debtor. Conversely, to accede to the wishes of the Trustees would be prejudicial to its own best business interest. Under the existing circumstances, no stigma is intended against N & W for pursuing accepted, good business dictates in selecting the course most beneficial to its own position even though the ultimate consequence of its action may, in some degree, irreparably injure the property of the Debtor.

Conscientious adherence to the Congressional mandate imposed upon the Court to protect and conserve the property of the Debtor permits no recourse but to relieve N & W of its burdensome conflict in discharging its fiduciary responsibilities.

The existence of exclusive summary jurisdiction over all property in the actual or constructive possession of the Debtor, including matters involving such property before the Commissioner of Internal Revenue or the Tax Court, does not mean that the reorganization court must necessarily assert its jurisdiction and restrain another forum with concurrent jurisdiction over the same matter from

proceeding. This is true whether the other forum be a state or federal court in the judicial branch of government, or an administrative body in the executive branch. *Thompson v. Magnolia Petroleum Co., supra*; *In Re Scranton Corporation, supra.*

The fundamental basis for restraining an action outside the reorganization court is that such action could unduly hinder, delay, burden, interfere, or be inconsistent with the pending corporate reorganization. In the case at bar, the Court makes no such finding. The Court defers to the Commissioner of Internal Revenue or the Tax Court for a determination of the issue of the validity of the existing affiliation between N & W and Erie for purpose of filing consolidated income tax returns.

To Summarize, the Court finds:

1. Tax attributes of the Debtor, including without limitation the right to exercise elections and take deductions and credits permitted under the Internal Revenue Code and the regulations issued thereunder, are property of the Debtor over which this Court has jurisdiction.

2. The choice of tax elections affects the tax basis of the Debtor's property and the future deductions which may be taken with respect to such property.

3. Some, if not all, of the tax elections which are available to the Debtor cannot be reversed or revoked once made.

4. The Debtor and its creditors will suffer irreparable injury if N & W is permitted to continue to make such tax elections and to take such deductions and credits which are available to the Debtor as N & W has made and taken in the past and as it intends to continue to make and take in the future.

5. The Debtor has no adequate remedy at law.

Accordingly, It Is Ordered:

1. The preliminary injunction heretofore issued is dissolved.

2. N & W and its directors, officers, employees, and agents be and they are hereby permanently enjoined from exercising or making any and all tax elections and from taking any and all deductions and credits which are available to the Debtor in the computation of its separate taxable income under the Internal Revenue Code and the regulations thereunder, except such tax elections, deductions, and credits as the Trustees, subject to the control of this Court, shall determine.

3. N & W be and it is hereby authorized to file on or before September 15, 1973 a consolidated federal income tax return including the income, deductions, and credits of the Debtor and its subsidiaries for the calendar year 1972, prepared in such manner with respect to the Debtor, making such tax elections and taking such deductions and credits which are available to the Debtor as the Trustees, subject to the control of this Court, determine.

4. The Trustees be and they hereby are authorized and directed to file on or before September 15, 1973 an income tax return for the Debtor and its subsidiaries for the period commencing June 27, 1972 and ending on December 31, 1972, prepared in such manner, making such tax elections and taking such deductions and credits as the Trustees shall determine.

5. N & W be and it is hereby directed and ordered to supply copies of all consolidated, combined, or joint tax returns, whether federal, state or local, which have been,

or may hereafter be, filed by N & W and which include the Debtor and to inform the Trustees in writing of all tax elections made and investment credits taken on such returns and the manner of preparation of such returns.

6. N & W be and it is hereby directed and ordered to advise the Trustees of all tax audits, tax proceedings, and other tax matters affecting the Debtor.

7. That this Court shall reserve decision and retain jurisdiction:

a. To determine the amount of compensation, if any, that N & W shall pay the Debtor for the past, present, or future use of the Debtor's tax attributes.

b. To determine all other issues raised by the Trustees' Application.

IT IS SO ORDERED.

/s/ ROBERT P. KRUPANSKY
United States District Judge

Dated: September 10, 1973

ORDER OF THE COURT OF APPEALS

(Filed September 14, 1973)

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

IN THE MATTER OF
ERIE LACKAWANNA RAILWAY COMPANY
Debtor

ORDER

Before: WEICK, CELEBREZZE and PECK, *Circuit Judges.*

Norfolk and Western Railway Company (N & W) has appealed to this Court from a permanent injunction against it entered in the reorganization proceeding of its wholly owned subsidiary, Erie Lackawanna Railway Company (Erie), Debtor, pending in the District Court under Section 77 of the Bankruptcy Act.

N & W is required by law to file its consolidated income tax return on or before September 17, 1973. In a summary proceeding in the District Court the Trustees for Erie challenged the right of N & W in its consolidated income tax return (not yet filed) to use losses and investment credits of Erie. The District Judge granted temporary and preliminary injunctions against N & W restraining it from so doing, and finally on September 10, 1973, granted the permanent injunction.

We granted an expedited appeal, convened a panel in Cleveland, Ohio, to hear oral arguments, and read the briefs of counsel, although this Court was in recess.

The pertinent provisions of the permanent injunction are as follows:

> "2. N & W and its directors, officers, employees, and agents be and they are hereby permanently enjoined from exercising or making any and all tax elections and from taking any and all deductions and credits which are available to the Debtor in the computation of its separate taxable income under the Internal Revenue Code and the regulations thereunder, except such tax elections, deductions, and credits as the Trustees, subject to the control of this Court, shall determine.
>
> "3. N & W be and it is hereby authorized to file on or before September 15, 1973 a consolidated federal income tax return including the income, deductions, and credits of the Debtor and its subsidiaries for the calendar year 1972, prepared in such manner with respect to the Debtor, making such tax elections and taking such deductions and credits which are available to the Debtor as the Trustees, subject to the control of this Court, determine."

N & W had been forced to acquire the controlling stock of Erie by order of the Interstate Commerce Commission (ICC), entered in an inclusion proceeding on April 1, 1968. These proceedings were instigated by Erie. The decision of ICC was affirmed by a three-Judge District Court in *Erie Lackawanna Ry. v. United States*, 279 F. Supp. 316, 346 (S.D. N.Y. 1967), and by the Supreme Court in *Penn. Central Merger Cases*, 389 U.S. 486, 525, 526 (1968). The price fixed by ICC for the exchange of stock was shares of N & W stock worth about $55,000,000.

The principal argument of Erie in these proceedings and before the Courts was that as a result of the merger N & W would realize large tax benefits. ICC stated:

"Even if EL earnings are not sufficient to support the proposed stock exchange ratios, N & W's investment in EL would be protected by [the] substantial tax benefits [described in the EL testimony]." (330 ICC at 846.)

Under applicable statutes and regulations N & W has been filing consolidated income tax returns since 1954. Upon its forced acquisition of all the common capital shares of Erie in 1968, N & W has since included in its consolidated tax return the income or losses and other tax attributes of Erie. It cannot now change without the consent of the Commissioner of Internal Revenue, who will undoubtedly audit these returns.

We can find no authority for a District Court, prior to the preparation and filing of a tax return to mandatorily order a taxpayer what income or deductions to include therein. The District Court seemed to recognize this thesis when it stated in its opinion:

"The fundamental basis for restraining an action outside the reorganization court is that such action could unduly hinder, delay, burden, interfere, or be inconsistent with the pending corporate reorganization. In the case at bar, the Court makes no such finding. The Court defers to the Commissioner of Internal Revenue or the Tax Court for a determination of the issue of the validity of the existing affiliation between N & W and Erie for purpose of filing consolidated income tax returns."

Other substantial issues in the case are whether the loss and other tax attributes of Erie constitute "property" vesting in the Trustees under the Bankruptcy Act. If property, did N & W acquire such rights under the hold-

ings of ICC and the Courts upholding the merger because such rights were available to N & W?

We are of the opinion that these issues were prematurely determined by the District Court.

We are of the further opinion that the Trustees have an adequate remedy at law, for in its opinion the District Court stated:

> "7. That this Court shall reserve decision and retain jurisdiction:
>
> "a. To determine the amount of compensation, if any, that N & W shall pay the Debtor for the past, present, or future use of the Debtor's tax attributes.
>
> "b. To determine all other issues raised by the Trustees' Application."

Thus, the question of whether the past, present or future tax attributes belong to Erie or N & W can later be determined by the District Court in the event that such issues are not adjudicated administratively by the Commissioner, the Tax Court or on appeal to a United States Court of Appeals.

It is therefore ORDERED that the judgment of the District Court be vacated; that the Trustees and N & W may file their own tax returns, in which they may include their income or deductions, the validity of which is subject to later determination administratively or by the Courts.

Entered by Order of the Court
/s/ JAMES A. HIGGINS
Clerk

BANKRUPTCY ACT, 11 U.S.C. §205

§ 205. Reorganization of railroads engaged in interstate commerce—Petition for reorganization by railroad, subsidiary or creditors; venue; proceedings thereon; jurisdiction of court over debtor and property

(a) Any railroad corporation may file a petition stating that it is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization. The petition shall be filed with the court in whose territorial jurisdiction such corporation, during the preceding six months or the greater portion thereof, has had its principal executive or operating office, and a copy of the petition shall at the same time be filed with the Interstate Commerce Commission (hereinafter called the "Commission"): *Provided,* That when any railroad, although engaged in interstate commerce, lies wholly within one State, such proceedings shall be brought in the Federal district court of the district in which its principal operating office in such State during the preceding six months or the greater portion thereof has been located. The petition shall be accompanied by payment to the clerk of a filing fee of $100, which shall be in addition to the fees required to be collected by the clerk under other sections of this title. Upon the filing of such a petition, the judge shall enter an order either approving it as properly filed under this section, if satisfied that such petition complies with this section and has been filed in good faith, or dismissing it, if he is not so satisfied. If the petition is so approved, the court in which such order is entered shall, during the pendency of the proceedings under this section and for the purposes thereof, have exclusive jurisdic-

tion of the debtor and its property wherever located, and shall have and may exercise in addition to the powers conferred by this section all the powers, not inconsistent with this section, which a Federal court would have had if it had appointed a receiver in equity of the property of the debtor for any purpose.

* * * * *

INTERNAL REVENUE CODE OF 1954, 26 U.S.C. §1502

Sec. 1502. Regulations.

The Secretary or his delegate shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability.

TREASURY REGULATIONS, 26 CFR §1.1502-77

§ 1.1502-77. Common parent agent for subsidiaries.

(a) *Scope of agency of common parent corporation.* The common parent, for all purposes other than the making of the consent required by paragraph (a) (1) of § 1.1502-75, shall be the sole agent for each subsidiary in the group,

duly authorized to act in its own name in all matters relating to the tax liability for the consolidated return year. No subsidiary shall have authority to act for or to represent itself in any such matter. For example, any election available to a subsidiary corporation in the computation of its separate taxable income must be made by the common parent, as must any change in an election previously made by the subsidiary corporation; all correspondence will be carried on directly with the common parent; the common parent shall file for all extensions of time including extensions of time for payment of tax under section 6164; notices of deficiencies will be mailed only to the common parent, and the mailing to the common parent shall be considered as a mailing to each subsidiary in the group; notice and demand for payment of taxes will be given only to the common parent and such notice and demand will be considered as a notice and demand to each subsidiary; the common parent will file petitions and conduct proceedings before the Tax Court of the United States, and any such petition shall be considered as also having been filed by each such subsidiary. The common parent will file claims for refund or credit, and any refund will be made directly to and in the name of the common parent and will discharge any liability of the Government in respect thereof to any such subsidiary; and the common parent in its name will give waivers, give bonds, and execute closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise, or any other document so executed, shall be considered as having also been given or executed by each such subsidiary.

COURT, U. S.
FILED
JAN 29 1974
MICHAEL RODAK, JR., CLE

No. 73-890

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

ERIE LACKAWANNA RAILWAY COMPANY, Debtor,
Petitioner,

vs.

NORFOLK AND WESTERN RAILWAY COMPANY,
Respondent.

BRIEF OF NORFOLK AND WESTERN RAILWAY COMPANY IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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No. 73-890

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

ERIE LACKAWANNA RAILWAY COMPANY, Debtor, Petitioner,

vs.

NORFOLK AND WESTERN RAILWAY COMPANY, Respondent.

BRIEF OF NORFOLK AND WESTERN RAILWAY COMPANY IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Norfolk and Western Railway Company respectfully submits this Brief in Opposition to the Petition for a Writ of Certiorari filed by the Erie Lackawanna Railway Company to review an order of the United States Court of Appeals for the Sixth Circuit entered on September 14, 1973.

JURISDICTION

The jurisdictional requisites are adequately set forth in the petition.

QUESTIONS PRESENTED

Petitioner has sought to raise questions which go far beyond the narrow issues decided by the Court of Appeals and which take no account of the nature of the federal income tax returns filed by petitioner and respondent fol-

lowing the Court of Appeals' decision. The questions actually presented in this case are:

1. Whether the Court of Appeals was correct in vacating an injunction which would have prevented the Norfolk and Western from filing its federal income tax return for the year 1972 in accordance with its rights and obligations under applicable provisions of the Internal Revenue Code and Income Tax Regulations.

2. Whether petitioner is entitled to or needs an injunction to restrain the Norfolk and Western from exercising its right to make elections in its consolidated tax return including the Erie for the year 1972, where the Erie Trustees had no interest in the Erie properties until June 26, 1972, and where the elections actually made in the Norfolk and Western's return were those urged by the Erie Trustees themselves for the period after that date.

STATUTES, REGULATIONS AND RULINGS INVOLVED

In addition to 11 U.S.C. Section 205 (Section 77(a) of the Bankruptcy Act), Section 1502 of the Internal Revenue Code of 1954, and Income Tax Regulations Section 1.1502-77, which appear in the Appendix to the Petition, Sections 1504(a) and (b) of the Internal Revenue Code of 1954, Section 1.1502-76(b)(1) of the Income Tax Regulations, and Revenue Ruling 63-104 appear in Appendix B hereto, *infra,* pp. B-1-B-4.

STATEMENT OF THE CASE

The Norfolk and Western Railway Company was compelled on April 1, 1968, to purchase 100% of the common stock of the Erie Lackawanna Railway Company under an order of the Interstate Commerce Commission which required the Norfolk and Western to exchange stock having a value of $55,026,000 for Erie stock. *Norfolk & Western Ry. Co. and New York, C. & St.L.R.Co. Merger,* 330 I.C.C. 780(1967). At the time of this acquisition, the Erie was in grave financial difficulty as a result of substantial losses

which it had suffered in the years prior to the acquisition and its prospects for continuing losses in future years. Notwithstanding its financial condition, the Erie contended in the proceedings before the Commission that the Norfolk and Western could fairly be compelled to acquire its stock at that price because of the tax advantages the Norfolk and Western would realize from inclusion of the Erie in a consolidated tax return and the use by the Norfolk and Western in that return of accelerated depreciation and other elections available under the Internal Revenue Code (JA 42-43;[1] Erie Reply Brief, ICC Docket No. 21510, Oct. 19, 1966, pp. 36-37):

> ". . . N&W could use EL's [Erie-Lackawanna's] investment credit and in addition obtain a tax deduction of at least $10.2 million per year by putting New EL on guidelines and accelerated depreciation . . . .
>
> "Because of those very real tax benefits, N&W is therefore certain to recover its investment in EL."

The Commission accepted this contention and, in reliance upon the tax savings which would be available after the acquisition, ordered the Norfolk and Western to pay the Erie the price it proposed (330 I.C.C. at 846):

> "Even if EL earnings are not sufficient to support the proposed stock exchange ratios, N&W's investment in EL would be protected by [the] substantial tax benefits [described in the EL testimony]."

The Commission's inclusion order was upheld by the United States District Court for the Southern District of New York on the basis of these same tax advantages. (*Erie Lackawanna R. Co.* v. *United States,* 279 F. Supp 316, 346 (1967)):

> "The Commission also correctly noted that 'even if E-L earnings are not sufficient to support the proposed

[1] The Joint Appendix in the Court of Appeals is referred to herein as "JA-. . . ."

> stock exchange ratios, N&W's investment is protected since E-L's income would be earned subject to five substantial tax benefits,' including several not heretofore mentioned. 330 I.C.C. 816 and 846-47. E-L's brief contains computations not challenged by N&W showing that tax savings will insure N&W's recovery of its $55 million investment in E-L within 10 years even if E-L earned nothing. In the light of all this, the Commission was justified in concluding that any overestimate of E-L's earning power was fully compensated, 330 I.C.C. at 816."

This Court affirmed the district court's decision and its findings of fact on this point. *Penn-Central Merger Cases,* 389 U.S. 486, 525-526 (1968).

Following its forced acquisition of the Erie, the Norfolk and Western filed consolidated tax returns in precisely the manner contemplated by the Commission's order. The Erie continued to suffer substantial losses which, when taken into the Norfolk and Western's consolidated return along with some of Erie's investment credits, produced substantial tax savings for the Norfolk and Western. However, the Norfolk and Western had not recouped even one-half of its investment in the Erie through such savings at the time this litigation was commenced (JA-5[illegible]).

The losses suffered by the Erie eventually forced it to file a petition for reorganization on June 26, 1972. The filing of this petition did not break the affiliation for tax purposes between the Norfolk and Western and the Erie under the applicable provisions of the Internal Revenue Code and Income Tax Regulations, nor did it relieve the Norfolk and Western of its obligation to include the Erie in its consolidated return. Nonetheless, in 1973, when the Norfolk and Western was preparing its 1972 return on a consolidated basis as required by the Income Tax Regulations, the Erie Trustees demanded that the tax benefits resulting from the Erie's inclusion in the consolidated

return be turned over to them. When the Norfolk and Western refused, the Trustees filed an application in the reorganization court on August 3, 1973, seeking, among other things, to enjoin the Norfolk and Western from including the tax attributes of the Erie in its 1972 consolidated return during the period after June 26, 1972, or, alternatively, to require the Norfolk and Western to report the operations of the Erie after that date on the basis specified by the Trustees. The application also sought compensation for all tax attributes of the Erie used by the Norfolk and Western since its forced acquisition and for any of those attributes that may be used in the future.

On the day the Trustees' application was filed, the district court issued a temporary order without notice restraining the Norfolk and Western from including the Erie in its 1972 consolidated income tax return for the period after the filing of the reorganization petition. Subsequently, in a decision handed down on September 10, 1973, the district court held that it need not resolve the question of whether the Erie could properly be included in the Norfolk and Western's consolidated return for the period after the filing of the petition for reorganization (A1, A11).[2] It permitted the Norfolk and Western to file a consolidated return including the Erie for 1972 but authorized and directed the Trustees to file a separate return for the Erie alone covering the period from June 27 through December 31, 1972—the portion of that year during which the Erie was in reorganization—thus leaving it to the Internal Revenue Service and reviewing courts to determine which return was correct for that period (A12). However, with respect to its consolidated return for the entire tax year, the district court went on to enjoin the Norfolk and Western (*id.*):

> ". . . from exercising or making any and all tax elections and from taking any and all deductions and

[2] The opinion of the district court and the opinion of the Court of Appeals are reproduced in the Appendix to the Petition, which is referred to herein as "A . . . ."

> credits which are available to the Debtor in the computation of its separate taxable income under the Internal Revenue Code and the regulations thereunder, except such tax elections, deductions, and credits as the Trustees, subject to the control of this Court, shall determine."

The district court expressly refused to find that this injunction was necessary to prevent acts that would "unduly hinder, delay, burden, interfere, or be inconsistent with the pending corporate reorganization" (A11). It did make a conclusory finding that the injunction was necessary to protect the Erie from irreparable injury (A11), but it nowhere explained how such injury could possibly flow from the filing of a return by the Norfolk and Western that would not and could not have any binding effect upon the Erie, since the Erie was filing its own separate return.

The Court of Appeals for the Sixth Circuit reversed the district court's decision on September 14, 1973 (A14). The Court of Appeals found that the Erie was not faced with irreparable injury from the filing by the Norfolk and Western of a consolidated tax return including the Erie, but, indeed, that the Erie has "an adequate remedy at law" for every claim that it asserted (A17). The Court of Appeals also pointed out that there are established administrative procedures for reviewing income tax returns filed by taxpayers and held that it was premature at this point for the district court to decide whether the Erie's tax attributes are property, and, if so, who owns that property (A16-17).

Following the Court of Appeals' decision, the Norfolk and Western proceeded to complete and file its 1972 income tax return. In doing so, the Norfolk and Western made its elections under the Internal Revenue Code with respect to the operations of the Erie so as to minimize, to the fullest extent permitted by law, the depreciation attributed to the assets of the Erie for the period following the date

of the filing of the petition for reorganization. A copy of that return was furnished to the Erie Trustees, who were specifically informed of the basis upon which it had been prepared. (See letter attached hereto as Appendix A, p. A-1, *infra.*)

The Norfolk and Western's 1972 return was filed on September 17, 1972, as required by law. The Erie Trustees also filed a return as had been directed by the district court. Since the Norfolk and Western's return minimized the depreciation attributed to the assets of the Erie, the effect of the Trustees' return upon the basis of those assets could not differ from that of the return filed by the Norfolk and Western for the period following the date of the filing of the petition for reorganization.

ARGUMENT

The petition for certiorari should be denied because, as will be shown below, it fails to meet any of this Court's standards governing the granting of such petitions. Moreover, as will also be shown, the petition should be denied because this case, in its present posture, does not actually present any substantial question which is appropriate for resolution by this Court.

I. THE COURT OF APPEALS WAS CORRECT IN VACATING THE INJUNCTION OF THE DISTRICT COURT.

As the Court of Appeals pointed out, both the structure and the purpose of the Internal Revenue Code and Regulations and Rulings promulgated thereunder flatly preclude the issuance of an injunction, either prohibiting a taxpayer from filing a consolidated return including all members of the affiliated group, as sought by the Trustees in the district court, or requiring that the return be prepared on a specified basis, as ordered by the district court and contended for by the Trustees here. An income tax return is strictly

a matter between the taxpayer filing that return and the Government. The sole purpose of the return is to state the taxpayer's position with respect to the taxes it owes the Government in accordance with applicable revenue laws. The filing of a return does not therefore affect the substantive rights of another party, either against the Government or against the taxpayer that prepared the return.

The Code and Regulations prescribe the method by which returns are to be prepared and filed by each taxpayer. Here the Code and Regulations make it plain that the Norfolk and Western not only is authorized, but is required, to file a consolidated return including the Erie for the entire tax year 1972. The Court of Appeals found (A16):

> "Under applicable statutes and regulations N&W has been filing consolidated income tax returns since 1954. Upon its forced acquisition of all the common capital shares of Erie in 1968, N&W has since included in its consolidated tax return the income or losses and other tax attributes of Erie. It cannot now change without the consent of the Commissioner of Internal Revenue, who will undoubtedly audit these returns."[3]

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[3] The obligation of the Norfolk and Western to include the Erie in its 1972 consolidated return arises from the provisions of sections 1504(a) and (b) of the Internal Revenue Code of 1954, Income Tax Regulations sections 1.1502-76(b)(1) and the fact that the Norfolk and Western has filed consolidated returns including the Erie in previous years. The fact that the Erie is now in reorganization proceedings does not affect this obligation of the Norfolk and Western. Revenue Ruling 63-104 provides (1963-1 Cum. Bull. 172):

> "An affiliated group of corporations, which has filed consolidated returns for prior taxable years, is required to file a consolidated return for a subsequent taxable year in which none of the exceptions provided in section 1.1502-11(a) [the predecessor to the currently effective section 1.1502-75(c)] of the Income Tax Regulations is applicable, even though a member of the group is involved in bankruptcy proceedings and the trustee in bankruptcy fails or refuses to file a Form 1122 consenting to the filing of such a return."

Petitioner has challenged this interpretation of the applicable provisions of the Internal Revenue Code and Income Tax Regulations by filing a separate return for a part of the tax year 1972.[4] By this filing, it placed all questions of the correctness both of its return and of the return filed by the Norfolk and Western squarely before the responsible federal administrative authorities which process such returns. However, petitioner is not content to let these authorities resolve those questions. Instead, it has asked this Court to substitute itself as the initial arbiter of the obligations of the Norfolk and Western and the Erie, as taxpayers, to the Government.

There is no legal basis whatever for such a resort to the courts for what amounts to a declaratory judgment as to the meaning of the Internal Revenue Code.[5] Petitioner has not cited—and our research has failed to disclose—a single case in which the obligation of a parent to include an affiliated subsidiary in its consolidated return has been nullified or controlled in any way by judicial decree prior to a determination by the taxing authorities. Indeed, we have been unable to find a single case prior to this one in which an injunction has been sought to prevent a taxpayer from filing its tax return on whatever basis it saw fit.

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[4] The Trustees did not ask and consequently were not granted permission to file a separate return for the part of 1972 preceding the filing of the petition for reorganization. Of course, if they had any legitimate doubt as to the correctness of the Norfolk and Western's return for that period, they should have requested the right to file a separate return for the period.

[5] 28 U.S.C. § 2201 forbids the federal courts from granting declaratory judgments in cases involving federal taxes. See *In re Statmaster Corp.*, 465 F.2d 978 (5th Cir. 1972); *Jolles Foundation* v. *Moysey*, 250 F.2d 166 (2nd Cir. 1957); *In re Inland Gas Corp.*, 241 F.2d 374 (6th Cir.), *cert. denied*, 355 U.S. 838 (1957); *Wilson* v. *Wilson*, 141 F.2d 599 (4th Cir. 1944).

The purpose of an income tax return, the clear requirements of the Internal Revenue Code, Regulations and Rulings, and the total absence of precedent to justify an injunction such as that sought by the Trustees led the Court of Appeals to conclude that the injunction issued by the district court should be vacated so that the entire matter can be left in the hands of the taxing authorities where it belongs. We submit that this decision was clearly correct.

Petitioner does not challenge, or indeed even mention, these clear provisions of the Internal Revenue Code and Income Tax Regulations or the established procedures by which tax controversies are resolved. Instead, it challenges the Court of Appeals' decision, and hence the Norfolk and Western's right even to present its position to the responsible taxing authorities, on the theory that all tax attributes arising from the operations of the Erie are "property" of the Erie which passed into the hands of the Erie Trustees upon the filing of its petition for reorganization. The short answer to this contention is that it is patently premature. As the Court of Appeals pointed out, the issue of whether the tax attributes of the Erie are property in the hands of the Erie Trustees may be rendered moot by the administrative proceedings which regularly follow the filing of income tax returns. The Court of Appeals did not attempt to anticipate or predict the outcome of the taxing authorities' proceedings. Instead, it held that the district court should await the outcome of such administrative proceedings before deciding a question that may become moot (A17):

> "Thus, the question of whether the past, present or future tax attributes belong to Erie or N&W can later be determined by the District Court in the event that

such issues are not adjudicated administratively by the Commissioner, the Tax Court or on appeal to a United States Court of Appeals."

This approach is clearly correct and consistent with the established principle that courts should not reach out to decide questions that may not have to be decided. This principle has been recognized in many cases decided by this Court. See, e.g., *Sanks* v. *Georgia,* 401 U.S. 144 (1971); *United States* v. *Fruehauf,* 365 U.S. 146 (1961); *Barr* v. *Mateo,* 355 U.S. 171 (1957); *Eccles* v. *Peoples Bank,* 333 U.S. 426, 432 (1948). It is particularly applicable here, where the question unnecessarily pressed involves a legal question which both the district court and the Erie Trustees recognize is one of first impression (JA-131; Petition, p. 10), and a fact situation that is unique.

There can be no justification for reaching out to decide an issue of this nature here, since it is clear, and indeed undisputed, the petitioner will suffer no loss from awaiting the determination of the correctness of its return and the Norfolk and Western's return by the responsible taxing authorities. Nothing that the Internal Revenue Service does or does not do with respect to the Norfolk and Western's return will affect the rights of the Erie with respect to its own returns. When and if the Erie earns income on which it would otherwise be obligated to pay taxes, the Erie will be entitled to assert any rights it may have to offset that income with losses carried over from its own return. The question of its tax liability will not be governed by any resolution that may have been made with respect to the Norfolk and Western's tax liability. Thus, as the Court of Appeals pointed out, "the Trustees have an adequate remedy at law" (A17), even if they are right on the sub-

stantive issues involved.[6] Petitioner in no way challenges this finding, which conclusively establishes that the issuance of the injunction by the district court was improper, and that the Court of Appeals was correct in vacating that injunction and deferring decision on the property issue.

II. THE FILING BY THE NORFOLK AND WESTERN OF A CONSOLIDATED RETURN, INCLUDING THE ERIE, FOR THE ENTIRE YEAR 1972 HAS NOT ERODED THE BASIS OF THE ASSETS OF THE BANKRUPT ESTATE.

The injunction of the district court having been vacated, the Norfolk and Western had a clear right, both under the Internal Revenue Code and Regulations and under the *Inclusion* order, to file its 1972 tax return in any manner it saw fit consistent with law, including the right to make any elections available to it under the Code and Regulations. However, as already pointed out, the Norfolk and Western prepared its 1972 return for the period following June 26, 1972, so as to minimize, to the full extent permitted by law, the depreciation attributable to the assets of the Erie. Petitioner has not identified any substantial difference between the return filed by the Norfolk and

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[6] The Norfolk and Western believes, and argued strongly in the Court of Appeals, that the Erie's tax losses are not property which passed to the Erie Trustees. Loss carryovers have no intrinsic value or legal status; their significance is created and wholly governed by the Internal Revenue Code, which requires the Norfolk and Western, in this case, to include the Erie's losses in its consolidated return. As pointed out below, (p. 16, *infra*), this Court has not decided, but, indeed, has expressly reserved the question of whether tax loss carryovers can ever properly be treated as property within the meaning of the Bankruptcy Act. As the Court of Appeals pointed out, this is an inappropriate case in which to resolve that question, since it may prove to be totally unnecessary. Moreover,

Western for this period and the separate return filed for the Erie by its Trustees at the direction of the district court.

Thus, petitioner's efforts to create the impression that the Norfolk and Western is eroding the tax basis of the assets of the bankrupt estate by elections it has chosen to make under the Internal Revenue Code are not sound. In view of the nature of the return filed by the Norfolk and Western, the only question of any practical significance presented at this stage of the case is whether the Erie Trustees have a right to control the Norfolk and Western's elections during the period *before* the filing of the petition for reorganization. We submit that it is clear that the Trustees have no legal basis for objecting to the Norfolk and Western's elections during this period—before they had any interest in the Erie. As shown above, the suggestion for placing the Erie on the tax basis chosen by the Norfolk and Western originated with the Erie itself as a justification for the price it compelled the Norfolk and Western to pay for its stock in the inclusion proceedings. The Interstate Commerce Commission expressly adopted this suggestion and ordered

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the circumstances under which the Norfolk and Western was compelled to acquire the Erie at a price which expressly took into account the benefit of the Erie's tax attributes, coupled with the fact that the Norfolk and Western has not now and will not for some time in the future recover its investment through use of these tax attributes, are also significant. These facts create a situation in which, even if the tax attributes of the Erie are regarded as property, such property belongs not to the Erie Trustees, but to the Norfolk and Western. The Court of Appeals also reserved this issue (A16-17). Since there is no precedent directly in point with respect to either of the issues reserved by the Court of Appeals, that court was clearly correct in holding that such novel, legal and factual questions should not be decided at this stage of the proceedings.

the inclusion at the proposed price on that basis. The *Inclusion* order was affirmed by the courts on the same basis. In these circumstances, the Norfolk and Western's elections with respect to the Erie prior to the date of the filing of the petition for reorganization were the direct product of the *Inclusion* order.

Petitioner's efforts to justify a legitimate interest in the Trustees in pre-reorganization tax attributes on the basis of Justice Jackson's dissent in *Western Pacific R. Corp.* v. *Western Pacific R. Co.*, 345 U.S. 247 (1953), and on *In re Bob Richards Chrysler-Plymouth Corp., Inc.*, 473 F.2d 262 (9th Cir.), *cert. denied*, 412 U.S. 919 (1973), and *Case* v. *New York Central R. Co.*, 15 N.Y.2d 150, 204 N.E.2d 643 (N.Y. Ct. App. 1965), are unfounded. Contrary to the implication in the petition (pp. 7-8), the portion of the Court of Appeals' decision in *Western Pacific* which this Court refused to review held that a company suffering a loss does not have an interest in that loss of a nature that would justify a court in compelling an affiliated company with income to pay for the tax benefits realized from using that loss (197 F.2d 994, 1004 (9th Cir. 1951)):

> "There is nothing in the Code or Regulations that compels the conclusion that a tax saving must or should inure to the benefit of . . . the company which has sustained the loss that makes possible the tax saving."

The *New York Central* case is to the same effect in that it held that courts will not impose obligations upon companies affiliated for tax purposes or modify agreements between them. *In re Bob Richards Chrysler-Plymouth* held only that a parent was not entitled to retain as a set-off a tax refund resulting from the carryback of a bankrupt subsidiary's net operating loss during the year of bankruptcy to reduce taxable income of the same subsidiary during

preceding years and with respect to which the subsidiary had paid tax. The Erie has had no taxable income and has paid no income tax since it was acquired by the Norfolk and Western. In any event, none of these cases involved the forced acquisition of a subsidiary and its tax attributes.

Petitioner's arguments that the Norfolk and Western has usurped the powers of the Trustees and somehow eroded the estate which passed into their hands thus really comes down to an effort to make this Court an "umpire to debates concerning harmless, empty shadows." *Poe* v. *Ullman*, 367 U.S. 497, 508 (1961). The Trustees had no legal interest in the Erie prior to the filing of the petition for reorganization, and nothing done by the Norfolk and Western during that period could remotely be characterized as illegal or improper. The Trustees themselves recognized this fact in requesting and obtaining from the district court permission to file a separate return only for the period after the filing of the petition for reorganization—June 27, 1972 through December 31, 1972 (A12). Moreover, for the entire period since the date of the filing for reorganization, the Trustees' wishes have been fully complied with. There is simply no genuine dispute for this Court to resolve with respect to the erosion of the bankrupt estate.

III. THERE IS NO CONFLICT AMONG THE CIRCUITS ON ANY QUESTION INVOLVED IN THIS CASE.

Petitioner's effort to demonstrate a conflict among the circuits on the question of whether the tax attributes of the Erie are property of the Trustees is patently unpersuasive. Not a single one of the cases cited by petitioner deals with the question of whether tax attributes, such as losses or depreciation, are property within the meaning of the Bankruptcy Act. Instead, most of the cases cited deal with the question of whether a tax refund to a wage earner resulting

from excess withholding of income tax from his pre-bankruptcy wages, but paid to him after the commencement of the bankruptcy proceedings, constitutes property passing to the trustee pursuant to the Bankruptcy Act.[7] The only other case cited, *In re Aveni*, 458 F.2d 972 (6th Cir.), *cert. denied*, 409 U.S. 877 (1972), is equally inapposite since it involved only the question of whether unpaid wages which had accrued to the bankrupt when the bankruptcy petition was filed were property passing to the trustee.

In *Segal* v. *Rochelle*, 382 U.S. 375 (1966), this Court held that inchoate claims for *refunds* resulting from a loss carryback are property within the meaning of the Bankruptcy Act, but expressly reserved the question of whether loss carryovers could properly be held to have that status (*id.*, at 381):

> "We are told that if this loss-carryback refund claim is 'property,' that label must also attach to loss-carryovers, that is, the application of pre-bankruptcy losses to earnings in future years. Since losses may be carried forward five years and in some cases even seven or ten years, I.R.C. §§ 172(b)(1)(B)-(D), great hardship for the estate is foreseen by petitioners in keeping it open for this length of time. While in fact the trustee can obviate this detriment to the estate—by selling a contingent claim in some instances or simply foregoing it—inconvenience and hindrance might be caused for the bankrupt individual. Without ruling in any way on a question not before us, it is enough to say that a carry-

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[7] *Compare, In re Kingswood*, 470 F.2d 996 (9th Cir. 1972), *rev'g* 343 F. Supp. 498 (C.D. Cal. 1972), *In re Cedor*, 337 F. Supp. 1103 (N.D. Cal.), *aff'd per curiam*, 470 F.2d 996 (9th Cir. 1972), *cert. denied*, 411 U.S. 973 (1973), *with, In re Kokoszka*, 479 F.2d 990 (2nd Cir. 1973), *In re Jones*, 337 F. Supp. 620 (D. Minn. 1971), *leave to appeal denied* (8th Cir. May 14, 1971), *cert. denied*, 404 U.S. 1040 (1972).

over into post-bankruptcy years can be distinguished conceptually as well as practically."[8]

There clearly is not a conflict on the question reserved in *Segal*. Indeed, the fact of the matter is that no Court of Appeals, including the Court of Appeals which decided this case, has passed upon that question. Nor is there any other reason for the Court to consider that question in this case.

IV. REVIEW OF THIS CASE IS NOT JUSTIFIED ON GROUNDS OF THE IMPORTANCE OF THE ISSUE INVOLVED OR ITS IMPACT UPON THE NORTHEASTERN RAILROADS.

Petitioner also seeks to justify review on the ground that the right of the Norfolk and Western to make elections with respect to a bankrupt subsidiary is an important issue in the administration of the Bankruptcy Act, and that the question of whether tax attributes are property has an important impact upon the Northeastern railroads. Neither of these contentions is sound.

We have already shown that the Norfolk and Western did not make elections of the nature complained of by the

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[8] There is an obvious difference, recognized by this Court in making the distinction in *Segal*, between a loss carryback *refund* where the income, as well as the offsetting loss, is earned by the bankrupt prior to the filing of the bankruptcy petition, and a loss *carryover* which may reduce tax liability, if at all, only when pre-bankruptcy losses of the bankrupt are utilized to reduce post-bankruptcy taxable income. As pointed out in Collier's basic treatise on Bankruptcy (4A Collier on Bankruptcy ¶ 70.28):

"The loss-carryforward claim seems much more replete with problems of an equitable nature and of a practical nature than the loss-carryback claim. It is clear that the Court has not answered the question at all except to the effect that the two situations are completely different."

petitioner with respect to the period following the filing of the petition for reorganization. Hence, this case poses no question of the kind characterized as novel and important by the petitioner.

The claim that the property question sought to be raised will have an important impact on the Northeastern railroads is equally unsupportable. The situation presented in this case is one that is unique among all of the bankrupt railroads in the Northeast, since the Erie is the only one of those railroads which is owned by a company which was compelled to buy it on the grounds of the tax advantages available. The issues raised in cases involving other Northeastern railroads are entirely different.[9]

Petitioner has also sought to create the impression that the questions presented here are "crucial" to the Erie's prospects of being reorganized as a viable, profitable railroad. This claim is flatly inconsistent with the findings of the district court, which expressly refused to find that its injunction was necessary to prevent any action which "could

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[9] The case cited involving the Lehigh Valley Railroad Company (E.D. Pa. Bankruptcy No. 70-432) is totally different from the question sought to be presented here. As the petition itself concedes (p. 11), the bankrupt railroad there is merely seeking permission to file a separate return, in addition to the consolidated return including it filed by its parent. The Erie trustees have already filed such a return with the permission of the bankruptcy court.

The controversy cited involving the Boston and Maine Railroad is fundamentally different from the situation here in that the Boston and Maine controversy does not involve the forced acquisition of an unprofitable railroad with the purchase price justified on the basis of tax savings to the acquiring corporation. Hence, it is clear that the resolution of whether the Erie's tax attributes are property passing to the trustee is not dispositive of whether the trustees of the Boston and Maine can compel compensation for use of their losses.

unduly hinder, delay, burden, interfere, or be inconsistent with the pending corporate reorganization" (A 11). Petitioner seeks to obviate this finding by reference to the Regional Rail Reorganization Act of 1973, which became law on January 2, 1974, Pub. L. No. 93-236. However, this law contains no provisions which would make the issue sought to be presented here any more important to the reorganization of the Erie than that issue would be under Section 77 of the Bankruptcy Act.

The district court's refusal to premise its injunction on the necessity of preventing an action which would frustrate the reorganization of the Erie under Section 77 of the Bankruptcy Act confirms the abstract nature of the questions sought to be presented to this Court. In these circumstances the Court of Appeals was correct in concluding that the Erie is faced with no irreparable injury by the return filed by the Norfolk and Western and that further judicial proceedings should be deferred until injury is incurred and administrative proceedings exhausted.

CONCLUSION

For the foregoing reasons, respondent requests that the petition for writ of certiorari be denied.

Respectfully submitted,

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January, 1974

APPENDIX A

September 17, 1973

Messrs. Ralph S. Tyler, Jr.,
and Thomas F. Patton
Trustees
Erie Lackawanna Railway Company
Midland Building
Cleveland, Ohio 44115

Dear Sirs:

The United States Court of Appeals for the Sixth Circuit having vacated the order of the District Court, Norfolk and Western has today filed its consolidated federal income tax return for the calendar year 1972 by including Erie Lackawanna for the full year.

For your information, this return reflects an annual depreciation allowance for Erie Lackawanna property of about $17.6 million. This depreciation was calculated on the basis of maximized deductions up to June 26, 1972, and minimized deductions thereafter. It compares with depreciation of about $24.6 million following procedures used in prior years.

Mr. Kiley will furnish Mr. Keenan with a copy of this return.

Sincerely,

/s/ John P. Fishwick

APPENDIX B

INTERNAL REVENUE CODE OF 1954, 26 U.S.C.

Sec. 1504. Definitions.

(a) DEFINITION OF "AFFILIATED GROUP".—As used in this chapter, the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

(1) Stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

(2) The common parent corporation owns directly stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of at least one of the other includible corporations.

As used in this subsection, the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(b) DEFINITION OF "INCLUDIBLE CORPORATION".—As used in this chapter, the term "includible corporation" means any corporation except—

(1) Corporations exempt from taxation under section 501.

(2) Insurance companies subject to taxation under section 802 or 821.

(3) Foreign corporations.

(4) Corporations entitled to the benefits of section 931, by reason of receiving a large percentage of their income from sources within possessions of the United States.

(5) Corporations organized under the China Trade Act, 1922.

(6) Regulated investment companies and real estate investment trusts subject to tax under subchapter M of chapter 1.

(7) A DISC or former DISC (as defined in section 9926).

INCOME TAX REGULATIONS, 26 CFR

Sec. 1.1502-76. Taxable Year of Members of Group.

* * * * *

(b) *Income to be included in returns for taxable year* —(1) *Inclusion of income in consolidated return.* The consolidated return of a group must include the income of the common parent for that corporation's entire taxable year (excluding any portion of such taxable year for which its income is properly included in the consolidated return of another group) and, except as provided in subparagraph (5) of this paragraph, the income of each subsidiary for the portion of such taxable year during which it was a member of the group. If § 1.1502-75(d)(2)(ii) applies to a group, then for purposes of this paragraph, the former common parent shall be deemed to continue in existence and shall be regarded as the common parent for the entire taxable year in which the acquisition occurs. If § 1.1502-75 (d)(3)(v) applies to a group, then for purposes of the application of this paragraph (other than to a group which ceases to exist as a result of the application of § 1.1502-75 (d)(3)(i)), the second corporation (whether or not it remains in existence) shall be treated as the common parent for the entire taxable year of such corporation in which the

acquisition occurs, and the first corporation shall be treated as a subsidiary for the portion of such taxable year subsequent to the acquisition.

REVENUE RULING 63-104, 1963-1 CUM. BULL. 172 (1963)

Advice has been requested whether, under the circumstances described, an affiliated group of corporations is required to make a consolidated return.

An affiliated group of corporations made consolidated returns for several years prior to the year in which a member of the group filed a voluntary petition in bankruptcy and was adjudicated a bankrupt. The trustee in bankruptcy failed to file a consent on Form 1122, Return of Information and Authorization and Consent of Subsidiary Corporation Included in a U.S. Consolidated Income Tax Return, to authorize the parent corporation to make a consolidated return on its behalf.

Section 1.1502-11(a) of the Income Tax Regulations provides, with certain exceptions not here pertinent, that, if a consolidated return is made for any taxable year, a consolidated return must be made for each subsequent taxable year during which the affiliated group remains in existence.

Section 1.1502-12(b) of the regulations provides, in pertinent part, that each subsidiary must prepare duplicate originals on Form 1122, consenting to the regulations under section 1502 of the Internal Revenue Code of 1954 and authorizing the common parent corporation to make a consolidated return on its behalf for the taxable year and authorizing the common parent (or, in the event of its failure, the Commissioner of Internal Revenue or the district director) to make a consolidated return on its behalf (as long as it remains a member of the affiliated group), for each year thereafter for which, under section 1.1502-11(a)

of the regulations, the making of a consolidated return is required.

Section 1.1502-12(d) of the regulations states that each return or form required to be made or prepared by a corporation must be executed by the person authorized under section 6062 of the Code to execute returns of separate corporations. In cases where a receiver or a trustee in bankruptcy is operating the property or business of a corporation, each return or form required to be made or prepared by such corporation must be executed by the receiver or trustee, as the case may be, pursuant to an order or instruction of the court, and be accompanied by a copy of such order or instructions.

Section 1.1502-18(a) of the regulations provides, in part, that, if there has been a failure to file any of the forms required by these regulations, notice thereof shall be given the common parent corporation by the Commissioner, and the tax liability of each member of the affiliated group shall be determined on the basis of separate returns unless such income is included or such forms are filed within the period prescribed in such notice, or any extension thereof, or unless under section 1.1502-11(a) of the regulations a consolidated return is required for such year.

Since section 1.1502-11(a) of the regulations makes no exceptions in the event of the bankruptcy of a member corporation, it is concluded that the general rule provided in that section is applicable even after a member corporation is adjudicated a bankrupt, unless one of the specific exceptions is applicable. This is consistent with the general rule that bankrupt corporations are treated the same as other corporations. See G.C.M. 12207, C.B. XII-2, 83 (1933).

Accordingly, assuming that none of the exceptions specifically provided in section 1.1502-11(a) of the regulations is applicable, it is held that the affiliated group is required to make a consolidated return.

SUPREME COURT, U. S.
FILED
FEB 11 19
MICHAEL RODAK, JR.

Supreme Court of the United States

October Term, 1973

No. 73-890

ERIE LACKAWANNA RAILWAY COMPANY, Debtor,
Petitioner,

vs.

NORFOLK AND WESTERN RAILWAY COMPANY,
Respondent.

On Petition For A Writ of Certiorari To The United States Court of Appeals For the Sixth Circuit

PETITIONER'S REPLY BRIEF

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Supreme Court of the United States

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PETITIONER'S REPLY BRIEF

It is with great reluctance that Petitioner (Debtor) files this Reply Brief. It feels compelled to do so by reason of Respondent's injection of new matter in its brief which has the effect of obfuscating the issues with respect to which a Writ of Certiorari is sought.

Norfolk and Western Railway Company in its Brief in Opposition to the Petition attempts to supplement the record in this case by referring to matters which took place subsequent to the decision by the Court of Appeals for the Sixth Circuit and by discussing issues as to which Petitioner does not seek a Writ of Certiorari.

I. THE CONSOLIDATED RETURN FOR 1972 FILED BY RESPONDENT AND THE ELECTION MADE THEREIN ARE NOT A PART OF THE RECORD AND ARE IN ANY EVENT IRRELEVANT.

Norfolk and Western Railway Company ("N & W") in its Brief refers to elections made by N & W in filing its 1972 consolidated return which included the income and deductions of Petitioner for the full year 1972. The content of that return is not a part of the record in this case, but even if it were the inclusion of that information begs the issue. The issue is not what elections N & W made in the 1972 return, but rather whether, as a proper matter of bankruptcy administration, elections with respect to methods of depreciation and amortization which affect the property of the Debtor are "property" of the Debtor subject to the exclusive control and jurisdiction of the District Court. Thus, the issue is not what elections were made but who has the right to make and exercise control over those elections. More specifically, that issue is as set forth in the Petition:

> "Whether the District Court in Fulfilling Its Duty to Protect the Property of the Debtor, Including Its Tax Attributes, Can Direct the Parent As to What Tax Elections Are to Be Made in a Consolidated Return Which Affect the Debtor's Property . . .".

This is a novel and important issue both in the administration of the bankruptcy laws and in the administration of the consolidated returns regulations.

II. PETITIONER DOES NOT SEEK REVIEW OF THAT PORTION OF THE COURT OF APPEALS' DECISION PERMITTING THE FILING OF A CONSOLIDATED RETURN BY N & W.

Petitioner does not seek a Writ of Certiorari with respect to the issue below as to whether or not N & W could be enjoined from filing a 1972 consolidated return which includes income and deductions of the Debtor for the period subsequent to the filing of the Petition for Reorganization under the bankruptcy laws. Petitioner ac-

cepted that aspect of the decision of the Court of Appeals. Nevertheless, Respondent seeks to confuse the situation by spending several pages in its Brief on that non-issue.

CONCLUSION

The issues as to which a Writ of Certiorari is sought are relatively narrow. They are:

1. Whether tax attributes constitute "property" for purposes of bankruptcy administration, and

2. Whether the District Court in fulfilling its duty to protect the property of the Debtor, including its tax attributes, can direct N & W, the parent, as to what tax elections are to be made in a consolidated return which affect the Debtor's property.

For the reasons set forth in the Petition, a Writ of Certiorari should issue.

Respectfully submitted,

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